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C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 000864

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SUBJECT: CROSS-STRAIT INVESTMENT RESTRICTIONS INCREASINGLY IRRELEVANT

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Classified By: AIT Acting Director David J. Keegan, Reason 1.4 b

Summary

¶1. (C) Approved investment by Taiwan firms in the PRC fell 13 percent in 2005, while the average size of investment projects grew substantially. Meanwhile, foreign investment in the PRC from the British Virgin Islands rose dramatically, suggesting that increasing amounts of Taiwan-origin investment in the PRC are being channeled through third territories to evade Taiwan restrictions. Two of the three largest investment projects approved by Taiwan in 2005 show how Taiwan firms are getting around investment restrictions. The statistics and the individual cases indicate that Taiwan's restrictions on investment in the PRC may be increasingly irrelevant. The Chen administration's call for more "active management" of Taiwan's investment in the PRC will not strengthen Taiwan government control; it will only exacerbate the tendency of Taiwan firms to find ways to evade controls. End summary.

Falling Total Investment and Larger Average Size

¶2. (U) Investment by Taiwan firms in the PRC fell by 13 percent in 2005 according to data on approved investment released by Taiwan's Ministry of Economic Affairs (MOEA) Investment Commission. After double digit growth for three straight years, approved investment dropped from US\$ 6.9 to US\$ 6.0 billion. The number of approved projects also declined to 1,297 from 2,004 in 2004 (coincidentally), but the average size of approved projects rose substantially from US\$ 3.46 million to US\$ 4.63 million.

¶3. (U) Taiwan's share of total foreign investment in the PRC also fell substantially for the third consecutive year. According to PRC data, investment from Taiwan accounted for only 3.6 percent of total realized foreign investment in the PRC. (Note: The PRC releases data on "contracted" foreign investment and "realized" foreign investment, which reports investment projects actually implemented during the year. End note.) Taiwan was the seventh largest source of foreign investment in the PRC, falling from number 6 last year. Singapore's investment in the PRC surpassed Taiwan's for the first time, accounting for 3.7 percent of foreign

investment in the PRC, compared to Taiwan's 3.6 percent. As recently as 2002, Taiwan accounted for 7.5 percent of realized investment in the PRC compared to Singapore's 4.4 percent.

More Investment From (Through) Caribbean

¶4. (U) Taiwan's declining share of investment in the PRC as shown in official PRC data may be due in part to increasing efforts of Taiwan firms to circumvent Taiwan controls by investing through third territories. British Virgin Islands investment in the PRC increased more than investment from any other country or economy. It jumped from US\$ 6.7 billion in 2004 to US\$ 9.0 billion last year. Its share of total foreign investment in the PRC rose from 11.1 percent in 2004 to 15.0 percent in 2005. Money from Taiwan accounts for a substantial portion of this investment. Similarly, the Cayman Islands accounted for 3.2 percent of realized investment in the PRC, the eighth largest source. (Note: It is difficult to estimate how much of the investment that comes from these Caribbean territories actually originates in Taiwan. Firms from other countries as well as Mainland investors seeking special terms offered to foreign investors also take advantage of these channels for investment. End note.)

Investment Continues with Cross-Straight Restrictions

¶5. (U) MOEA's released data on two of the three largest approved projects in 2005 reinforces the conclusion that, despite Taiwan's restrictions, firms that face cross-Straight

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restrictions continue to invest there. China Airlines was approved to invest US\$ 40 million in Yangtze River Express, a PRC air cargo carrier (reported reftel). Yang Ming Marine Transport and Wan Hai lines, Taiwan shipping companies who are CAL's partners in the venture, were approved to invest US\$ 19.2 million and US\$ 9.6 million respectively. This investment will help China Airlines and the two shipping companies penetrate the Mainland's growing cargo market despite the lack of direct air and shipping links.

¶6. (SBU) MOEA also approved Formosa Chemicals and Fibre Corp., a unit in the Formosa Plastics Group, to invest US\$ 47.5 million in hydroxybenzene and acetone production and sales facilities. These are downstream products made from the output of naptha crackers. Taiwan still prohibits naptha cracker investment in the Mainland. However, Formosa Chemicals and Fibre may plan to integrate these new facilities with naptha cracker investment in the future.

Comment - Increasing Irrelevance

¶7. (C) Last year's investment data suggest that Taiwan's restrictions on cross-Straight economic activity are increasingly irrelevant. Some of the largest projects approved by MOEA indicate that Taiwan firms are finding more ways around the restrictions and are making preparations for their eventual liberalization. There also appears to be an increasing trend of Taiwan firms evading Taiwan government control by channeling that investment through other territories. The decline in the average size of investment may indicate that primarily smaller firms are inhibited by Taiwan's restrictions. The government's response to these trends is the call for more "active management" of Taiwan's investment in the PRC. The tighter restrictions that "active management" implies may only exacerbate the tendency of Taiwan firms to find ways to escape government control. End comment.

KEEGAN